

though it were the only branch of A Corporation, branch C is treated as a separate wholly owned subsidiary corporation of A Corporation, the 20 percent rate of tax on the income of such branch being less than 90 percent of, and at least 5 percentage points less than, the 50 percent rate of tax which would apply to the income of branch C under the laws of country X if, under the laws of such country, all the income of A Corporation for 1963 derived through the home office and branch C were derived from sources within country X. The income derived by branch B and branch C, respectively, each treated as a separate corporation, from the sale by or through each of them for use, consumption, or disposition outside country Y and country Z, respectively, is treated as income from the sale of personal property on behalf of A Corporation, a related person, and constitutes foreign base company sales income for 1963. The home office of A Corporation, treated as a separate corporation, derives no foreign base company sales income for 1963 since it produces the articles which are sold.

Example 6 [Reserved]

Example 7 [Reserved]

(c) *Effective/applicability date.* Paragraphs (a)(1)(i), (a)(1)(iii) *Example 1*, (a)(1)(iii) *Example 2*, (a)(2), (a)(4)(i), (a)(4)(ii), (a)(4)(iii), (a)(4)(iv) and (a)(6)(i) shall apply to taxable years of controlled foreign corporations beginning after June 30, 2009, and for taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end.

(d) *Application of regulations to earlier taxable years.* A taxpayer may choose to apply these regulations and the regulations under § 1.954-3T retroactively with respect to its open taxable years. The taxpayer may so choose if and only if the taxpayer and all members of the taxpayer's affiliated group (within the meaning of § 1504(a)) apply both these regulations and the regulations under § 1.954-3T, in their entirety, to the earliest taxable year of each controlled foreign corporation that ends with or within an open taxable year of the taxpayer and to all subsequent taxable years of the taxpayer.

[T.D. 6734, 29 FR 6392, May 15, 1964, as amended by T.D. 7545, 43 FR 32754, May 8, 1978; T.D. 7893, 48 FR 22508, May 19, 1983; T.D. 7894, 48 FR 22523, May 19, 1983; T.D. 9008, 67 FR 48025, July 23, 2002; T.D. 9438, 73 FR 79344, T.D. 9438, Dec. 29, 2008; 74 FR 11844, Mar. 20, 2009]

§ 1.954-3T Foreign base company sales income (temporary).

(a) Through (b)(1)(i)(b) [Reserved] For further guidance, see § 1.954-3(a) through (b)(1)(i)(b).

(c) *Use of more than one branch.* If a controlled foreign corporation carries on purchasing or selling activities by or through more than one branch or similar establishment located outside the country under the laws of which such corporation is created or organized, then § 1.954-3(b)(1)(i)(b) shall be applied separately to the income derived by each such branch or similar establishment (by treating such purchasing or selling branch or similar establishment as if it were the only branch or similar establishment of the controlled foreign corporation and as if any such other branches or similar establishments were separate corporations) in determining whether the use of such branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. See paragraph (b)(1)(ii)(c)(I) of this section for rules applicable to a controlled foreign corporation that carries on purchase or sales activities by or through one or more branches or similar establishments in addition to carrying on manufacturing activities by or through one or more branches or similar establishments.

(ii) *Manufacturing branch—(a) In general.* If a controlled foreign corporation carries on manufacturing, producing, constructing, growing, or extracting activities by or through a branch or similar establishment located outside the country under the laws of which such corporation is created or organized and the use of the branch or similar establishment for such activities with respect to personal property purchased or sold by or through the remainder of the controlled foreign corporation has substantially the same tax effect as if the branch or similar establishment were a wholly owned subsidiary corporation of such controlled foreign corporation, the branch or

similar establishment and the remainder of the controlled foreign corporation will be treated as separate corporations for purposes of determining foreign base company sales income of such corporation. See section 954(d)(2). The provisions of this paragraph (b)(1)(ii) and § 1.954-3(b)(1)(ii)(b) will apply only if the controlled foreign corporation (including any branches or similar establishments of such controlled foreign corporation) manufactures, produces, or constructs such personal property within the meaning of § 1.954-3(a)(4)(i), or carries on growing or extracting activities with respect to such personal property.

(b) [Reserved] For further guidance, see § 1.954-3(b)(1)(ii)(b).

(c) *Use of more than one branch—(1) Use of one or more sales or purchase branches in addition to a manufacturing branch.* If, with respect to personal property manufactured, produced, constructed, grown, or extracted by or through a branch or similar establishment located outside the country under the laws of which the controlled foreign corporation is created or organized, purchasing or selling activities are carried on by or through more than one branch or similar establishment, or by or through one or more branches or similar establishments located outside such country, of such corporation, then § 1.954-3(b)(1)(ii)(b) shall be applied separately to the income derived by each such purchasing or selling branch or similar establishment (by treating such purchasing or selling branch or similar establishment as though it alone were the remainder of the controlled foreign corporation) for purposes of determining whether the use of such manufacturing, producing, constructing, growing, or extracting branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. If this rule applies, the sales or purchase branch rules contained in paragraph (b)(1)(i)(c) of this section and § 1.954-3(b)(1)(i) do not apply. The application of this paragraph (b)(1)(ii)(c)(I) is illustrated by the following example:

Example. All activities of controlled foreign corporation conducted through sales branches

and manufacturing branch. (i) *Facts.* FS, a controlled foreign corporation organized under the laws of country M, operates three branches. Branch A, located in country A, manufactures Product X under the principles of § 1.954-3(a)(4)(i). Branch B, located in Country B, sells Product X manufactured by Branch A to customers for use outside of Country B. Branch C, located in Country C sells Product X manufactured by Branch A to customers for use outside of Country C. FS does not conduct any manufacturing or selling activities apart from the activities of Branches A, B and C. Country M imposes an effective rate of tax on sales income of 0%. Country A imposes an effective rate of tax on sales income of 20%. Country B imposes an effective rate of tax on sales income of 20%. Country C imposes an effective rate of tax on sales income of 18%.

(ii) *Result.* Pursuant to this paragraph (b)(1)(ii)(c)(I), § 1.954-3(b)(1)(ii)(b) is applied to the sales income derived by Branch B by treating Branch B as though it alone were the remainder of the controlled foreign corporation. The use of Branch B does not have the same tax effect as if Branch B were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch B under § 1.954-3(b)(1)(ii)(b) (20%) is not less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of Country A (20%), the country in which Branch A is located. Section 1.954-3(b)(1)(ii)(b) is applied separately to the sales income derived by Branch C by treating Branch C as though it alone were the remainder of the controlled foreign corporation. The use of Branch C does not have the same tax effect as if Branch C were a wholly owned subsidiary of FS because the tax rate applicable to the income allocated to Branch C under § 1.954-3(b)(1)(ii)(b) (18%) is not less than 90 percent of, and at least 5 percentage points less than, the effective rate of tax which would apply to such income under the laws of Country A (20%), the country in which Branch A is located. Pursuant to this paragraph (b)(1)(ii)(c)(I), the rules under paragraph (b)(1)(i)(c) of this section and § 1.954-3(b)(1)(i) for determining whether a sales or purchase branch is treated as a separate corporation from the remainder of the controlled foreign corporation do not apply.

(2) *Use of more than one branch to manufacture, produce, construct, grow, or extract separate items of personal property.* If a controlled foreign corporation carries on manufacturing, producing, constructing, growing, or extracting activities with respect to separate items of personal property by or through more than one branch or similar establishment located outside the

country under the laws of which such corporation is created or organized, then paragraph (b)(1)(ii)(c) of this section and § 1.954-3(b)(1)(ii)(b) will be applied separately to each such branch or similar establishment (by treating such manufacturing branch or similar establishment as if it were the only such branch or similar establishment of the controlled foreign corporation and as if any other such branches or similar establishments were separate corporations) for purposes of determining whether the use of such branch or similar establishment has substantially the same tax effect as if such branch or similar establishment were a wholly owned subsidiary corporation of the controlled foreign corporation. The application of this paragraph (b)(1)(ii)(c)(2) is illustrated by the following example:

Example. Multiple branches that satisfy § 1.954-3(a)(4)(i). (i) *Facts.* FS is a controlled foreign corporation organized in Country M. FS operates two branches, Branch A and Branch B located in Country A and Country B, respectively. Branch A and Branch B each manufacture separate items of personal property (Product X and Product Y, respectively) within the meaning of § 1.954-3(a)(4)(ii) or (iii). Raw materials used in the manufacture of Product X and Product Y are purchased by FS from an unrelated person. FS engages in activities in Country M to sell Product X and Product Y to a related person for use, disposition or consumption outside of Country M. Employees of FS located in Country M perform only sales functions. The effective rate of tax imposed in Country M on the income from the sales of Product X and Product Y is 10%. Country A imposes an effective rate of tax on sales income of 20%. Country B imposes an effective rate of tax on sales income of 12%.

(ii) *Result.* Pursuant to this paragraph (b)(1)(ii)(c)(2), § 1.954-3(b)(1)(ii)(b) is applied separately to Branch A and Branch B with respect to the sales income of FS attributable to Product X (manufactured by Branch A) and Product Y (manufactured by Branch B). Because the effective rate of tax on FS's sales income from the sale of Product X in Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (20%), the use of Branch A to manufacture Product X has substantially the same tax effect as if Branch A were a wholly owned subsidiary corporation of FS. Because the effective rate of tax on FS's sales income from the sale of Product Y in

Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch B is located (12%), the use of Branch B to manufacture Product Y does not have substantially the same tax effect as if Branch B were a wholly owned subsidiary corporation of FS. Consequently, only Branch A is treated as a separate corporation apart from the remainder of FS for purposes of determining foreign base company sales income from the sales of Product X.

(3) *Use of more than one manufacturing branch, or one or more manufacturing branches and the remainder of the controlled foreign corporation, to manufacture, produce, or construct the same item of personal property—(i) In general.* This paragraph (b)(1)(ii)(c)(3) applies to determine the location of manufacture, production, or construction of personal property for purposes of applying § 1.954-3(b)(1)(i)(b) or (b)(1)(ii)(b) where more than one branch (or similar establishment) of a controlled foreign corporation, or one or more branches (or similar establishments) of a controlled foreign corporation and the remainder of the controlled foreign corporation, each engage in manufacturing, producing, or constructing activities with respect to the same item of personal property which is then sold by the controlled foreign corporation. This paragraph (b)(1)(ii)(c)(3) is applied separately with respect to the income derived by each purchasing or selling branch (or similar establishment) or purchasing or selling remainder of the controlled foreign corporation as provided under paragraphs (b)(1)(i) and (b)(1)(ii) of this section and §§ 1.954-3(b)(1)(i) and (b)(1)(ii). The location of manufacture, production, or construction is determined under paragraph (b)(1)(ii)(c)(3)(ii) of this section if one or more branches (or similar establishments), or the remainder of the controlled foreign corporation, independently satisfies § 1.954-3(a)(4)(i) with respect to an item of personal property. The location of manufacture, production, or construction is determined under paragraph (b)(1)(ii)(c)(3)(iii) of this section if none of the branches (or similar establishments), or the remainder of the controlled foreign corporation, independently satisfies § 1.954-

3(a)(4)(i) with respect to an item of personal property, but the controlled foreign corporation as a whole makes a substantial contribution to the manufacture, production or construction of that property within the meaning of § 1.954-3(a)(4)(iv). For purposes of this paragraph (b)(1)(ii)(c)(3), the location of any activity with respect to the manufacture, production, or construction of an item of personal property is determined under paragraph (b)(1)(ii)(c)(3)(iv) of this section. For purposes of this paragraph (b)(1)(ii)(c)(3), if multiple branches (or similar establishments) are located in a single jurisdiction, then the activities of those branches will be aggregated for purposes of determining whether a branch or remainder of the controlled foreign corporation satisfies § 1.954-3(a)(4)(i).

(ii) *Manufacture, production, or construction in one or more locations.* If only one branch (or similar establishment), or only the remainder of a controlled foreign corporation, independently satisfies § 1.954-3(a)(4)(i) with respect to an item of personal property, then that branch (or similar establishment) or the remainder of the controlled foreign corporation will be the location of manufacture, production, or construction of that property for purposes of applying § 1.954-3(b)(1)(i)(b) or (b)(1)(ii)(b) to the income from the sale of that property. See paragraph (b)(1)(ii)(c)(3)(v) *Example 1* of this section. If more than one branch (or similar establishment), or one or more branches (or similar establishments) and the remainder of the controlled foreign corporation, each independently satisfy § 1.954-3(a)(4)(i) with respect to an item of personal property, then the location of manufacture, production, or construction of that property for purposes of applying § 1.954-3(b)(1)(i)(b) or (b)(1)(ii)(b) will be the location of that branch (or similar establishment) or the jurisdiction under the laws of which the remainder of the controlled foreign corporation is organized that satisfies § 1.954-3(a)(4)(i) and that would, after applying § 1.954-3(b)(1)(ii)(b) to such branch (or similar establishment) or § 1.954-3(b)(1)(i)(b) to the remainder of the controlled foreign corporation, impose the lowest effective

rate of tax on the income allocated to such branch or the remainder of the controlled foreign corporation under such section (that is, either § 1.954-3(b)(1)(i)(b) or (b)(1)(ii)(b)). See paragraph (b)(1)(ii)(c)(3)(v) *Example 2* of this section.

(iii) *No location independently satisfies manufacturing test.* If none of the branches (or similar establishments) or the remainder of the controlled foreign corporation independently satisfies § 1.954-3(a)(4)(i) with respect to an item of personal property but the controlled foreign corporation as a whole makes a substantial contribution to the manufacture, production, or construction of that property within the meaning of § 1.954-3(a)(4)(iv), then for purposes of applying § 1.954-3(b)(1)(i)(b) or (b)(1)(ii)(b), the location of manufacture, production, or construction with respect to the income derived by a purchasing or selling branch (or similar establishment) or the purchasing or selling remainder of the controlled foreign corporation in connection with the purchase or sale of that property will be the “tested manufacturing location” unless the “tested sales location” provides a demonstrably greater contribution to the manufacture, production, or construction of the property. The tested manufacturing location is the location of any branch (or similar establishment) or remainder of the controlled foreign corporation that contributes to the manufacture, production, or construction of the personal property, if any, that would, after applying § 1.954-3(b)(1)(ii)(b) to such branch (or similar establishment) or § 1.954-3(b)(1)(i)(b) to the remainder of the controlled foreign corporation, be treated as a separate corporation and would impose the lowest effective rate of tax on the income allocated to such branch (or similar establishment) or to the remainder of the controlled foreign corporation under such section (that is, either § 1.954-3(b)(1)(ii)(b) or (b)(1)(i)(b)). The tested sales location is the location of the purchasing or selling branch (or similar establishment) or the remainder of the controlled foreign corporation by or through which the purchasing or selling activities are carried on with respect to the personal

property. For purposes of this paragraph (b)(1)(ii)(c)(3)(iii), the contribution to the manufacture, production, or construction of the personal property by the tested sales location will be deemed to include the activities of any branch (or similar establishment) or remainder of the controlled foreign corporation that would not be treated as a corporation separate from the tested sales location after the application of § 1.954-3(b)(1)(ii)(b) or (b)(1)(i)(b). For purposes of this paragraph (b)(1)(ii)(c)(3)(iii), the contribution of the tested manufacturing location to the manufacture, production, or construction of the personal property will be deemed to include any activities of any branch (or similar establishment) or remainder of the controlled foreign corporation that would be treated as a corporation separate from the tested sales location after the application of § 1.954-3(b)(1)(ii)(b) or (b)(1)(i)(b). Whether the tested sales location provides a demonstrably greater contribution to the manufacture, production, or construction of the personal property is determined by weighing the relative contributions to the manufacture, production, or construction of that property by the tested sales location and the tested manufacturing location under the facts and circumstances test provided in § 1.954-3(a)(4)(iv). See (b)(1)(ii)(c)(3)(v) *Examples 3, 4, 5, and 6* of this section. If the tested sales location provides a demonstrably greater contribution to the manufacture, production, or construction of the personal property than the tested manufacturing location or if there is no tested manufacturing location, then the tested sales location is the location of manufacture, production, or construction of that property and the rules of paragraph (b)(1)(ii)(a) of this section and § 1.954-3(b)(1)(i)(a) will not apply with respect to the income derived by the tested sales location in connection with the purchase or sale of that property and the use of that purchasing or selling branch (or similar establishment) or the purchasing or selling remainder will not result in a branch being treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section or § 1.954-3(b)(2)(ii).

(iv) *Location of activity.* For purposes of paragraph (b)(1)(ii)(c)(3) of this section, the location of any activity with respect to the manufacture, production, or construction of an item of personal property is the location where the employees of the controlled foreign corporation perform such activity. For example, the location of any activity concerning intellectual property is determined based on where employees of the controlled foreign corporation develop, or direct the use or development of, the intellectual property, not on the formal assignment of that intellectual property.

(v) *Examples.* The following examples illustrate the application of this paragraph (b)(1)(ii)(c)(3):

Example 1. Multiple branches contribute to the manufacture of a single product, only one branch satisfies § 1.954-3(a)(4)(i). (i) *Facts.* FS is a controlled foreign corporation organized in Country M. FS operates three branches, Branch A, Branch B, and Branch C, located respectively in Country A, Country B, and Country C. Branch A, Branch B, and Branch C each performs different manufacturing activities with respect to the manufacture of Product X. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, provides quality control and oversight and direction. Branch C, through the activities of employees of FS located in Country C, manufactures Product X (within the meaning of § 1.954-3(a)(4)(ii) or (a)(4)(iii)) using the designs developed by Branch A and under the oversight of the quality control personnel of Branch B. The activities of Branch A and Branch B do not independently satisfy § 1.954-3(a)(4)(i). Employees of FS located in Country M purchase the raw materials used in the manufacture of Product X from a related person and control the work-in-process and finished goods throughout the manufacturing process. Employees of FS located in Country M also manage the manufacturing costs and capacities related to Product X. Further, employees of FS located in Country M oversee the coordination between the branches. The activities of the remainder of FS in Country M do not independently satisfy § 1.954-3(a)(4)(i). Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. The sales income from the sale of Product X is taxed in Country M at an effective rate of tax of 10%. Country C imposes an effective rate of tax of 20% on sales income.

(ii) *Result.* Country C is the location of manufacture for purposes of applying § 1.954-3(b)(1)(ii)(b) because only the activities of

Branch C independently satisfy § 1.954-3(a)(4)(i). The use of Branch C has substantially the same tax effect as if Branch C were a wholly owned subsidiary corporation of FS because the effective rate of tax on the sales income (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch C is located (20%). Therefore, sales of Product X by the remainder of FS are treated as sales on behalf of Branch C. In determining whether the remainder of FS will qualify for the manufacturing exception under § 1.954-3(a)(4)(iv), the activities of FS will include the activities of Branch A or Branch B, respectively, if each of those branches would not be treated as a separate corporation under § 1.954-3(b)(1)(ii)(b), if that paragraph were applied independently to each of Branch A and Branch B. See paragraph (b)(2)(ii)(a) of this section.

Example 2. Multiple branches satisfy § 1.954-3(a)(4)(i) with respect to the same product sold by the controlled foreign corporation. (i) *Facts.* Assume the same facts as in *Example 1*, except for the following. In addition to the design of Product X, Branch A also performs in Country A other manufacturing activities, including those ascribed to FS in *Example 1*, that are sufficient to qualify as manufacturing under § 1.954-3(a)(4)(iv) with respect to Product X. Country A imposes an effective rate of tax of 12% on sales income.

(ii) *Result.* Branch A and Branch C through their activities each independently satisfy the requirements of § 1.954-3(a)(4)(i). Therefore, § 1.954-3(b)(1)(ii)(b) is applied by comparing the effective rate of tax imposed on the income from the sales of Product X against the lowest effective rate of tax that would apply to the sales income in either Country A or Country C if § 1.954-3(b)(1)(ii)(b) were applied separately to Branch A and Branch C. Country A imposes the lower effective rate of tax, and therefore, Branch A is treated as the location of manufacture for purposes of applying § 1.954-3(b)(1)(ii)(b). The effective rate of tax in Country B is not considered because Branch B does not satisfy § 1.954-3(a)(4)(i). Neither Branch A nor Branch C is treated as a separate corporation because the effective rate of tax on the sales income of FS from the sale of Product X (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (12%). Sales of Product X by the remainder of the controlled foreign corporation are not treated as made on behalf of any branch.

Example 3. Determining the location of manufacture when manufacturing activities performed by multiple branches and no branch independently satisfies § 1.954-3(a)(4)(i). (i) *Facts.* FS, a controlled foreign corporation organized in Country M, purchases raw ma-

terials from a related person. The raw materials are manufactured (under the principles of § 1.954-3(a)(4)(ii) or (a)(4)(iii)) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. FS has two branches, Branch A and Branch B, located in Country A and Country B respectively. Branch A, through the activities of employees of FS located in Country A, designs Product X. Branch B, through the activities of employees of FS located in Country B, controls manufacturing related logistics, provides oversight and direction during the manufacturing process, and controls the raw materials and work-in-process. FS manages the manufacturing costs and capacities related to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the branches. Employees of FS located in Country M also sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%, and Country B imposes an effective rate of tax on sales income of 24%. Neither the remainder of FS, nor any branch of FS independently satisfies § 1.954-3(a)(4)(i). However, under the facts and circumstances of the business, FS as a whole provides a substantial contribution to the manufacture of Product X within the meaning of § 1.954-3(a)(4)(iv).

(ii) *Result.* Based on the facts, neither the remainder of FS (through the activities of its employees in Country M) nor any branch of FS independently satisfies § 1.954-3(a)(4)(i) with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provides a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (20%), and Country A has the lowest effective rate of tax among the manufacturing branches that would, after applying § 1.954-3(b)(1)(ii)(b), be treated as a separate corporation. The activities of Branch B will be included in the contribution of Branch A for purposes of determining the location of

manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (24%). Under the facts and circumstances of the business, the activities of the remainder of FS would not provide a demonstrably greater contribution to the manufacture of Product X than the activities of Branch A and Branch B, considered together. Therefore, the location of manufacture is Country A, the location of Branch A.

Example 4. Manufacturing activities performed by multiple branches, no branch independently satisfies § 1.954-3(a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation, remainder contribution includes branch manufacturing activities.. (i) *Facts.* The facts are the same as *Example 3*, except that the effective rate of tax on sales income in Country B is 12%. In addition, under the facts of the particular business, the activities of employees of FS located in Country B and Country M, if considered together, would provide a demonstrably greater contribution to the manufacture of Product X than the activities of employees of FS located in Country A.

(ii) *Result.* Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies § 1.954-3(a)(4)(i) with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch A is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (20%), and Branch A is the only branch that would, after applying § 1.954-3(b)(1)(ii)(b), be treated as a separate corporation. The activities of Branch B will be included in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (12%). Under a facts and circumstances analysis, considered together, the activities of Branch

B and the remainder of FS would provide a demonstrably greater contribution to the manufacture of Product X than the activities of Branch A. Therefore, the rules of paragraph (b)(1)(ii)(a) of this section will not apply with respect to the income derived by the remainder of FS in connection with the sale of Product X, and neither Branch A nor Branch B will be treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section and § 1.954-3(b)(2)(ii).

Example 5. Manufacturing activities performed by multiple branches, no branch independently satisfies § 1.954-3(a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation and a sales branch. (i) *Facts.* The facts are the same as *Example 3*, except that sales of Product X are also carried on through Branch D in Country D, and Country D imposes a 16% effective rate of tax on sales income. In addition, under the facts and circumstances of the business, the activities of employees of FS located in Country A and Country M, considered together, would provide a demonstrably greater contribution to the manufacture of Product X than the activities of employees of FS located in Country B.

(ii) *Result.* Based on the facts, neither the remainder of FS nor any branch of FS independently satisfies § 1.954-3(a)(4)(i) with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, and Branch B each provide a contribution through the activities of their employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. Further, pursuant to paragraph (b)(1)(ii)(c)(1) of this section, paragraph (b)(1)(ii)(c)(3)(iii) of this section must be applied separately to the sales income derived by the remainder of FS and Branch D respectively. The results with respect to income derived by the remainder of FS in connection with the sale of Product X in this *Example 5* are the same as in *Example 3*. However, paragraph (b)(1)(ii)(c)(3)(iii) of this section must also be applied with respect to Branch D because the sale of Product X is also carried on through Branch D. Thus, for purposes of that sales income, the location of Branch D is the tested sales location. The location of Branch B is the tested manufacturing location because the effective rate of tax imposed on Branch D's sales income by Country D (16%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country B (24%), and Branch B is the only branch that would, after applying § 1.954-3(b)(1)(ii)(b), be treated as a separate corporation. The manufacturing activities performed in Country M by the remainder of FS and the manufacturing activities

performed in Country A by Branch A will be included in Branch D's contribution to the manufacture of Product X for purposes of determining the location of manufacture of Product X with respect to Branch D's sales income because the effective rate of tax imposed on the sales income by Country D (16%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country M (10%) and Country A (20%). Under the facts and circumstances of the business, the activities of Branch D, Branch A, and the remainder of FS, considered together, would provide a demonstrably greater contribution to the manufacture of Product X than the activities of Branch B. Therefore, the rules of paragraph (b)(1)(ii)(a) of this section will not apply with respect to the income derived by Branch D in connection with the sale of Product X and the use of Branch D to sell Product X will not result in a branch being treated as a separate corporation for purposes of paragraph (b)(2)(ii) of this section and § 1.954-3(b)(2)(ii).

Example 6. Determining the location of manufacture when employees of remainder of controlled foreign corporation travel to location of unrelated contract manufacturer to perform manufacturing activities. (i) *Facts.* FS, a controlled foreign corporation organized in Country M, purchases raw materials from a related person. The raw materials are manufactured (under the principles of § 1.954-3(a)(4)(ii) or (a)(4)(iii)) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion of the raw materials in Country C. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Employees of FS located in Country M engage in product design, manage the manufacturing costs and capacities with respect to Product X, and direct the use of intellectual property for the purpose of manufacturing Product X. Quality control and oversight and direction of the manufacturing process are conducted in Country C by employees of FS who are employed in Country M but who regularly travel to Country C. Branch A, located in Country A, is the only branch of FS. Product design with respect to Product X conducted by employees of FS located in Country A is supplemental to the bulk of the design work, which is done by employees of FS located in Country M. At all times, employees of Branch A control the raw materials, work-in-process and finished goods. Employees of FS located in Country A also control manufacturing related logistics with respect to Product X. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 20%. Neither the remainder of FS nor Branch A independently

satisfies § 1.954-3(a)(4)(i). However, under the facts and circumstance of the business, FS as a whole (including Branch A) provides a substantial contribution to the manufacture of Product X within the meaning of § 1.954-3(a)(4)(iv).

(ii) *Result.* Based on the facts, neither the remainder of FS nor Branch A independently satisfies § 1.954-3(a)(4)(i) with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS and Branch A each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The tested manufacturing location is the location of Branch A because the effective rate of tax imposed on the remainder of FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (20%), and Branch A is the only branch that would, after applying § 1.954-3(b)(1)(ii)(b), be treated as a separate corporation. Although the activities of traveling employees are considered in determining whether FS, as a whole, makes a substantial contribution to the manufacture of Product X under § 1.954-3(a)(4)(iv), the activities of the employees of FS that are performed in Country C are not taken into consideration in determining whether Country M, the jurisdiction under the laws of which FS is organized, is the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. Activities of employees performed outside the jurisdiction in which the controlled foreign corporation is organized and outside a location in which the controlled foreign corporation maintains a branch or similar establishment, are not considered in determining the location of manufacture. Under the facts and circumstances of the business, the activities of employees of FS performed in Country M do not provide a demonstrably greater contribution to the manufacture of Product X than the activities of employees of FS performed in Country A. Therefore, the location of manufacture is Country A, the location of Branch A.

(4) *Use of more than one branch to manufacture, produce, construct, grow, or extract separate items of personal property.* For purposes of paragraphs (b)(1)(ii)(c)(2) and (b)(1)(ii)(c)(3) of this section, an *item* of personal property refers to an individual unit of personal property rather than a type or class of personal property.

(2) [Reserved] For further guidance, see § 1.954-3(b)(2).

(i) [Reserved] For further guidance, see § 1.954-3(b)(2)(i).

(a) Treatment as separate corporations. [Reserved] For further guidance, see § 1.954-3(b)(2)(i)(a).

(b) *Activities treated as performed on behalf of the remainder of corporation.* (1) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property manufactured, produced, constructed, grown, or extracted by the remainder of the controlled foreign corporation, be treated as performed on behalf of the remainder of the controlled foreign corporation.

(2) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property (other than property described in paragraph (b)(2)(i)(b)(1) of this section) purchased or sold, or purchased and sold, by the remainder of the controlled foreign corporation (or any branch treated as the remainder of the controlled foreign corporation), be treated as performed on behalf of the remainder of the controlled foreign corporation.

(c) through (e) [Reserved] For further guidance, see § 1.954-3(b)(2)(i)(c) and (e)

(ii) [Reserved] For further guidance, see § 1.954-3(b)(2)(ii).

(a) *Treatment as separate corporations.* The branch or similar establishment will be treated as a wholly owned subsidiary corporation of the controlled foreign corporation, and such branch or similar establishment will be deemed to be incorporated in the country in which it is located. For purposes of applying the rules of this paragraph (b)(2)(ii) and § 1.954-3(b)(2)(ii), a branch or similar establishment of a controlled foreign corporation treated as a separate corporation purchasing or selling on behalf of the remainder of the controlled foreign corporation under paragraph (b)(2)(ii)(b) of this section, or the remainder of the controlled foreign corporation treated as a separate corporation purchasing or selling on behalf of a branch or similar establishment of the controlled foreign cor-

poration under § 1.954-3(b)(2)(ii)(c), will include any other branch or similar establishment or remainder of the controlled foreign corporation that would not be treated as a separate corporation (apart from the branch or similar establishment of a controlled foreign corporation that is treated as performing purchasing or selling activities on behalf of the remainder of the controlled foreign corporation under paragraph (b)(2)(ii)(b) of this section or the remainder of the controlled foreign corporation that is treated as performing purchasing or selling activities on behalf of the branch or similar establishment under § 1.954-3(b)(2)(ii)(c)) if the effective rate of tax imposed on the income of the purchasing or selling branch or similar establishment, or purchasing or selling remainder of the controlled foreign corporation, were tested under the principles of § 1.954-3(b)(1)(i)(b) or (b)(1)(ii)(b) against the effective rate of tax that would apply to such income if it were considered derived by such other branch or similar establishment or the remainder of the controlled foreign corporation.

(b) *Activities treated as performed on behalf of the remainder of corporation.* (1) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property manufactured, produced, constructed, grown, or extracted by the remainder of the controlled foreign corporation, be treated as performed on behalf of the remainder of the controlled foreign corporation.

(2) With respect to purchasing or selling activities performed by or through the branch or similar establishment, such purchasing or selling activities will, with respect to personal property (other than property described in paragraph (b)(2)(ii)(b)(1) of this section) purchased or sold, or purchased and sold, by the remainder of the controlled foreign corporation (or any branch treated as the remainder of the controlled foreign corporation), be treated as performed on behalf of the remainder of the controlled foreign corporation.

(c) and (d) [Reserved] For further guidance, see § 1.954-3(b)(2)(ii)(c) and (d).

(e) *Comparison with ordinary treatment.* Income derived by a branch or similar establishment, or by the remainder of the controlled foreign corporation, shall not be determined to be foreign base company sales income under paragraph (b) of this section or § 1.954-3(b) if the income would not be so considered if it were derived by a separate controlled foreign corporation under like circumstances.

(f) [Reserved] For further guidance, see § 1.954-3(b)(2)(ii)(f).

(3) [Reserved] For further guidance, see § 1.954-3(b)(3).

(4) *Illustrations.* The application of this paragraph (b)(4) may be illustrated by the following examples:

Examples (1) and (2). [Reserved] For further guidance, see § 1.954-3(b)(4) *Examples (1) and (2)*.

Example (3). (i) *Facts.* Corporation E, a controlled foreign corporation incorporated under the laws of foreign Country X, is a wholly owned subsidiary of Corporation D, also a controlled foreign corporation incorporated under the laws of Country X. Corporation E maintains Branch B in foreign Country Y. Both corporations use the calendar year as the taxable year. In 1964, Corporation E's sole activity, carried on through Branch B, consists of the purchase of articles manufactured in Country X by Corporation D, a related person, and the sale of the articles through Branch B to unrelated persons. One hundred percent of the articles sold through Branch B are sold for use outside Country X and 90 percent are also sold for use outside of Country Y. The income of Corporation E derived by Branch B from such transactions is taxed to Corporation E by Country X only at the time Corporation E distributes such income to Corporation D and is taxed on the basis of what the tax (a 40 percent effective rate) would have been if the income had been derived in 1964 by Corporation E from sources within Country X from doing business through a permanent establishment therein. Country Y levies an income tax at an effective rate of 50 percent on income derived from sources within such country, but the income of Branch B for 1964 is effectively taxed by Country Y at a 5 percent rate since under the laws of such country, only 10 percent of Branch B's income is derived from sources within such country. Corporation E makes no distributions to Corporation D in 1964.

(ii) *Result.* In determining foreign base company sales income of Corporation E for

1964, Branch B is treated as a separate wholly owned subsidiary corporation of Corporation E, the 5 percent rate of tax being less than 90 percent of, and at least 5 percentage points less than the 40 percent rate. Income derived by Branch B, treated as a separate corporation, from the purchase from a related person (Corporation D), of personal property manufactured outside of Country Y and sold for use, disposition, or consumption outside of Country Y constitutes foreign base company sales income. If, instead, Corporation D were unrelated to Corporation E, none of the income would be foreign base company sales income because Corporation E would be purchasing from and selling to unrelated persons and if Branch B were treated as a separate corporation it would likewise be purchasing from and selling to unrelated persons. Alternatively, if Corporation D were related to Corporation E, but Branch B manufactured the articles prior to sale under the principles of § 1.954-3(a)(4)(iv), the income would not be foreign base company sales income because Branch B, treated as a separate corporation, would qualify for the manufacturing exception under § 1.954-3(a)(4).

Examples (4) through (7) [Reserved] For further guidance, see § 1.954-3(b)(4) *Examples (4) through (7)*." is corrected to read "[Reserved] For further guidance, see § 1.954-3(b)(4) *Examples (4) and (5)*.

Example (8). *Uniformly applicable incentive tax rate in one country.* (i) *Facts.* FS is a controlled foreign corporation organized in Country M. FS operates one branch, Branch A, located in Country A. Branch A manufactures Product X within the meaning of § 1.954-3(a)(4)(ii) or (a)(4)(iii). Raw materials used in the manufacture of Product X are purchased by FS from an unrelated person. FS engages in activities in Country M to sell Product X to a related person for use outside of Country M. Employees of FS located in Country M carry on only sales functions. The effective rate imposed in Country M on the income from the sale of Product X is 10%. Country A generally imposes an effective rate of tax on income of 20%, but imposes a uniformly applicable incentive rate of tax of 10% on manufacturing income and related sales income.

(ii) *Result.* The use of Branch A to manufacture Product X does not have substantially the same tax effect as if Branch A were a wholly owned subsidiary corporation of FS because the effective rate of tax on FS's sales income from the sale of Product X in Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in the country in which Branch A is located (10%). Consequently, pursuant to § 1.954-3(b)(1)(ii)(b), Branch A is not treated as a separate corporation apart from the

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remainder of FS for purposes of determining foreign base company sales income.

Example (9). Manufacturing activities performed by multiple branches, no branch independently satisfies § 1.954-3(a)(4)(i), selling activities carried on by remainder of the controlled foreign corporation, some branch manufacturing activities included in remainder contribution. (i) *Facts.* FS, a controlled foreign corporation organized in Country M, has three branches, Branch A, Branch B, and Branch C, located in Country A, Country B, and Country C respectively. FS purchases raw materials from a related person. The raw materials are manufactured (under the principles of § 1.954-3(a)(4)(ii) or (a)(4)(iii)) into Product X by CM, an unrelated corporation, pursuant to a contract manufacturing arrangement. CM physically performs the substantial transformation, assembly, or conversion required to manufacture Product X outside of FS's country of organization. FS manages the manufacturing costs and capacities with respect to the manufacture of Product X through employees located in Country M. Further, employees of FS located in Country M oversee the coordination between the branches. Branch A, through the activities of employees of FS located in Country A, designs Product X, controls manufacturing related logistics, and controls the raw materials and work-in-process during the manufacturing process. Branch B, through the activities of employees of FS located in Country B, provides quality control. Branch C, through the activities of employees of FS located in Country C, provides and oversight and direction during the manufacturing process. Employees of FS located in Country M sell Product X to unrelated persons for use outside of Country M. Country M imposes an effective rate of tax on sales income of 10%. Country A imposes an effective rate of tax on sales income of 12%, Country B imposes an effective rate of tax on sales income of 24%, and Country C imposes an effective rate of tax on sales income of 25%. None of the remainder of FS, Branch A, Branch B, or Branch C independently satisfies § 1.954-3(a)(4)(i). However, under the facts and circumstances of the business, FS, as a whole, provides a substantial contribution to the manufacture of Product X within the meaning of § 1.954-3(a)(4)(iv). Under the facts and circumstances of the business, the activities of the remainder of FS and Branch A, if considered together, would not provide a demonstrably greater contribution to the manufacture of Product X than the activities of Branch B and Branch C, if considered together. Under the facts and circumstances of the business, however, the activities of the employees of the remainder of FS and Branch A, if considered together, would constitute a substantial contribution to the manufacture of Product X.

(ii) *Result.* Based on the facts, neither the remainder of FS (through activities of its employees in Country M) nor any branch of FS independently satisfies § 1.954-3(a)(4)(i) with respect to Product X, but FS, as a whole, provides a substantial contribution through the activities of its employees to the manufacture of Product X. The remainder of FS, Branch A, Branch B, and Branch C each provide a contribution through the activities of employees to the manufacture of Product X. Therefore, FS must determine the location of manufacture under paragraph (b)(1)(ii)(c)(3)(iii) of this section. The tested sales location is Country M because the selling activities with respect to Product X are carried on by the remainder of FS. The location of Branch B is the tested manufacturing location because the effective rate of tax imposed on FS's sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than the effective rate of tax that would apply to such income in Country B (24%), and Country B has the lowest effective rate of tax among the manufacturing branches that would, after applying § 1.954-3(b)(1)(ii)(b), be treated as a separate corporation. The manufacturing activities performed in Country A by Branch A, will be included in the contribution of the remainder of FS for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is not less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country A (12%). The manufacturing activities performed in Country C by Branch C will be included in the contribution of Branch B for purposes of determining the location of manufacture of Product X because the effective rate of tax imposed on the sales income by Country M (10%) is less than 90% of, and at least 5 percentage points less than, the effective rate of tax that would apply to such income in Country C (25%). Under the facts and circumstances of the business, the manufacturing activities of the remainder of FS and Branch A, considered together, would not provide a demonstrably greater contribution to the manufacture of Product X than the activities of Branch B and Branch C, considered together. Therefore, the location of manufacture is Country B, the location of Branch B. In determining that Country B is the location of manufacture, it was determined that after applying § 1.954-3(b)(1)(ii)(b) Branch B would be treated as a separate corporation under paragraph (b)(1)(ii)(a) of this section for purposes of determining foreign base company sales income. To determine whether income from the sale of Product X is foreign base company sales income, the remainder of FS takes into account the activities of Branch A because, under paragraph (b)(2)(ii)(a) of this section, Branch A would

not be treated as a separate corporation apart from FS. The remainder of FS is considered to have manufactured Product X under § 1.954-3(a)(4)(i) because the manufacturing activities of the remainder of FS and Branch A, considered together, would make a substantial contribution to the manufacture of Product X within the meaning of § 1.954-3(a)(4)(iv). Therefore, income derived from the sale of Product X by the remainder of FS does not constitute foreign base company sales income.

(c) [Reserved] For further guidance, see § 1.954-3(c).

(d) [Reserved] For further guidance, see § 1.954-3(d).

(e) *Effective/applicability date of temporary regulations.* Paragraphs (b)(1)(i)(c), (b)(1)(ii)(a), (b)(1)(ii)(c), (b)(2)(i)(b), (b)(2)(ii)(a), (b)(2)(ii)(b), (b)(2)(ii)(e), and (b)(4) *Example (3), Example (8), and Example (9)* of this section shall apply to taxable years of controlled foreign corporations beginning after June 30, 2009, and for taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end.

(f) *Application of temporary regulations to earlier taxable years.* For the application of these temporary regulations retroactively with respect to taxable years of controlled foreign corporations and to open taxable years of United States shareholders in which or with which such taxable years of the controlled foreign corporations end, see § 1.954-3(d).

(g) *Expiration date.* The applicability of this section expires on or before December 23, 2011.

[T.D. 9438, 73 FR 79344, Dec. 29, 2008; 74 FR 11844, Mar. 20, 2009]

§ 1.954-4 Foreign base company services income.

(a) *Items included.* Except as provided in paragraph (d) of this section, foreign base company services income means income of a controlled foreign corporation, whether in the form of compensation, commissions, fees, or otherwise, derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which—

(1) Are performed for, or on behalf of a related person, as defined in paragraph (e)(1) of § 1.954-1, and

(2) Are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

(b) *Services performed for, or on behalf of, a related person—*(1) *Specific cases.* For purposes of paragraph (a)(1) of this section, “services which are performed for, or on behalf of, a related person” include (but are not limited to) services performed by a controlled foreign corporation in a case where—

(i) The controlled foreign corporation is paid or reimbursed by, is released from an obligation to, or otherwise receives substantial financial benefit from, a related person for performing such services;

(ii) The controlled foreign corporation performs services (whether or not with respect to property sold by a related person) which a related person is, or has been, obligated to perform;

(iii) The controlled foreign corporation performs services with respect to property sold by a related person and the performance of such services constitutes a condition or a material term of such sale; or

(iv) Substantial assistance contributing to the performance of such services has been furnished by a related person or persons.

(2) *Special rules—*(i) *Guaranty of performance.* Subparagraph (1)(ii) of this paragraph shall not apply with respect to services performed by a controlled foreign corporation pursuant to a contract the performance of which is guaranteed by a related person, if (a) the related person’s sole obligation with respect to the contract is to guarantee performance of such services, (b) the controlled foreign corporation is fully obligated to perform the services under the contract, and (c) the related person (or any other person related to the controlled foreign corporation) does not in fact (1) pay for performance of, or perform, any of such services the performance of which is so guaranteed or (2) pay for performance of, or perform, any significant services related to such services. If the related person (or any other person related to the controlled foreign corporation) does in fact pay